APPROVAL OF PILOT BUILDING RENOVATION PLANS AND CONDOMINIUM RENOVATION LENDING DEVELOPMENTS

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OVERVIEW

This trip report describes progress under RFS 515: Rehabilitation and Major Repair Projects for Condominiums in Hungary. Marvin Price traveled to Hungary from May 31- June 11, 1998 and worked with Éva GerÅhazi of MRI. Carol Rabenhorst joined the Team for a few selected meetings.

The objectives of this trip were to:

! Follow up and continue the activities of the April 1998 trip by Martha Davis.

! Review progress made in the development of renovation work plans and financing scenarios for each of the pilot buildings subsequent to the April trip.

! Assist the common representatives and/or audit committees to frame their renovation plans for presentation to their General Assemblies and attend General Assembly meetings.

! Work with lenders to further define/understand loan products and underwriting criteria.

! Work with municipalities to further develop loan/grant/subsidy programs for condominium renovation.

During the early months of the year each of the demonstration buildings developed their own strategies regarding the planning, financing and execution of renovation projects. MRI and Urban Institute assisted them in this effort. Common representatives and executive committees prepared to present these plans to their annual General Assembly meetings for approval by the owners. Meeting schedules slipped, so that some buildings were finishing the process at the time of this trip.

The Team continued to focus attention on renovation lending during this trip, and reviewed the final version of OTP's new lending regulations for its condominium renovation loan program with Mrs. Harkainé of OTP. Some issues remain to be clarified at the branch level, but the approved version is not likely to be modified any time in the near future.

MISKOLC BUILDINGS

Széchenyi ut. 56

On Tuesday, June 2, a General Assembly meeting was held to follow up the May 28 meeting which was not valid due to the absence of MIK. This June 3 meeting was valid. Again about 2/3 of the private owners attended, and the meeting occupied the better part of three hours. Mr. Paszk presented well and the discussion was thorough.

Again the owners confirmed a renovation plan estimated to cost 2.5 million HUF. This is the so-called “baseline” plan which Mr. Paszk and the audit committee had settled on at the time of the March trip.

Much of the discussion centered on financing the project—specifically bank loans. The owners had previously been informed that OTP was developing a program to lend directly to owners’ associations, and this was the direction recommended by Mr. Paszk and the audit committee. It was pointed out, however, that security would have to be provided for the loan in the form of individual liens on units. Some owners were strongly against liens and offered to pay cash instead. The final resolution was to give owners the choice of paying cash for their pro rata share of the renovation cost or participating in the association financing. The total loan amount would be reduced as individuals paid cash.

Éva GerÅhazi and Mr. Paszk agreed to meet with the Miskolc OTP branch as soon as the regulations for the new loan program were finalized and distributed to the branches.

Ifuság ut. 14

This building held its General Assembly meeting on May 18. At that meeting no action was taken on renovation. The owners did vote to start a renovation fund and approved a common assessment of 50 HUF/square meter, which includes 8 HUF/square meter for the renovation fund. Given the poor financial condition of this building and its large arrearages, renovation is not likely to occur in the near future.

FelzÅruzsin 2

At its General Assembly meeting this building’s owners voted an increased common assessment to allow them to start a renovation fund. The targeted amount is 8 HUF/square meter. This is in addition to the contract savings plan the building started one year ago. This association is marginally better off financially than Ifuság. There is interest in renovating the roof, and there is a possibility the building might be able to participate in the municipal tender program when it is finalized. Eva will follow up on this with the building.

SZÉKESFEHÉRVÁR BUILDINGS

Sarló 16

At the General Assembly meeting the owners had previously approved a renovation program costing 2.42 million HUF. They approved a financing plan whereby the association would borrow 1.7 million HUF from OTP. Subsequent to that meeting the common representative, Mr. Jurkuljak has continued to solicit bids from contractors, to gather materials for the loan package and to prepare documents necessary for municipal approval.

Éva GerÅhazi and Mr. Jurkuljak plan to meet with the Székesfehérvár OTP branch as soon as the regulations for the new loan program were finalized and distributed to the branches.

Szabadságharcos 49-53

On Wednesday, June 3, a meeting of owners was held in follow up to the May 25 meeting. Éva GerÅhazi reported that the earlier meeting had turned very bad, ending with the resignation of the common representative, Mrs. Lepsenyi. Éva, Marvin Price and Mrs. Csizmadia attended the June 3 meeting.

At the June 3 meeting there was not a quorum, so no official business was conducted. There was a short spirited discussion from which we could make the following observations:

There are two diverse contingents among the residents. One consists of young, aggressive individuals and couples. The other consists of retirees, many of whom are widows or widowers. The two groups appear to have significant difficulties agreeing on any substantive issues. The common representative, though well intentioned and reasonably competent, has lost the confidence of a majority of the owners in both groups.

Another meeting was scheduled for June 8.

Again Éva GerÅhazi, Marvin Price and Mrs. Csizmadia attended the June 8 meeting. We arranged to meet with Mrs. Lepsenyi before the meeting to plan and prepare—to give her as much support as possible.

The priority work for this building involves the roof. Mrs. Lepsenyi received 6 bids, all within 200,000 HUF of one another. The minium price to do the roof, lightning arrestors and chimneys was 1.7 million HUF. The roof must be done all at one time; it cannot be done in two parts.

One contractor offered to defer a part of the cost. He asks 50 percent up front and 50 percent in six months. His price for the roof is 1.4 million HUF. Assuming the balance of the work costs 300,000 HUF, a total of 1 million HUF would be needed now and 700,000 HUF in six months. The association would need to come up with 300,000 HUF in new money over and above the renovation fund. We suggested this could come from a small loan secured by the rental stream from the commercial flat owned by the association. A 500,000 HUF, 5 year loan would have monthly payments of 10,000 HUF. If rented, the flat should yield a net rent of 8-10,000 HUF per month.

The meeting was held; although a quorum was not present, under the law a quorum was not required. Mrs Lepseny presented the following alternatives which we had decided upon:

Alternative 1—A 2.1 million HUF program including the roof, lightning arrestors, chimneys and rain drains. This program would entail greater borrowing and liens on individual units.

Alternative 2—A 1.7 million HUF program including the roof, lightning arrestors and chimneys. This work would be funded from the renovation fund and a loan secured by the commercial unit – assuming it was leased.

Alternative 3—The same scope as Alternative 2, but funded entirely from savings. The monthly renovation fund contribution would be raised from 15 HUF/square meter to 20 HUF/square meter, raising the annual contribution from 400,000 HUF to 533,333 HUF.

Alternative 4—Postpone the roof and renovate the sanitary sewer system and raindrains, funding from savings.

After discussion the second alternative was approved by a vote of 22 to 1. The association also revised a former resolution requiring a 12,000 HUF minimum rent on the commercial unit, authorizing the common representative to rent at whatever rate the market will bear. Parenthetically, after the meeting Mrs. Lepsenyi went directly to meet with a prospective tenant willing to pay 10,000 HUF per month.

The second matter on the agenda for this meeting was the resignation and replacement of the common representative. There was a heated discussion which only served to emphasize that there is a great schism between the old and young in the building and that the bad feelings between Mrs. Lepsenyi on the one hand and many residents on the other hand is probably irreparable. All the same most people present were reluctant to accept the resignation, because they did not want to face the chore of hiring a new common representative. Mrs. Csizmadia spoke up and convinced all present that this was probably one of those times when it would be best for the building and the common representative that a new common representative be found.

Keleman Béla ut. 13-17r

On June 10 Éva GerÅhazi and Marvin Price met with Mrs. Varga, who represents stairs 15 and 17. She informed us that the separation documents had been submitted to the municipality for registration and were awaiting Szepho execution. They had just that day learned that there was one additional required municipal document approving subdivision of the ground, but that it would be forthcoming soon.

The building divided into three separate associations. Mrs. Varga is the common representative for two—15 and 17. All 15 units in stair 17 are privately owned. 2 of 15 in stair 15 are municipally owned, but the tenant in one of those intends to purchase it. Each stair has separate operating and renovation accounts.

At June 1, 1998, renovation accounts for stair 15 and stair 17 were 130,000 HUF and 132,000 HUF respectively. The monthly contribution is 7 HUF/square meter, or 6,160 HUF per stair. One apartment is in arrears, but the owner has paid regularly in the past.

Operating costs run 22,380 HUF per stair per month, excluding renovation contribution. This is approximately 21 HUF per square meter, excluding the management fee of 4 HUF per square meter. The assessment has not been raised in two years.

Stair 15 has no operational reserves, because they have had to make a lot of repairs due to vandalism (i.e., the doorbell system). Stair 17 has 115,000 HUF in operational reserves. They were helped by the fact that they could rent out their commercial space one year earlier than could stair 15. Each stair has two storage spaces that are used by the municipality. The municipality pays only the renovation fund contribution. Each stair has a commercial space (formerly storage) which they rent out. They receive 8,000 HUF monthly rent for each and collect an additional 2,000 HUF tax from each tenant; they remit this tax to the municipality. The lease contracts are month to month.

The building roof area of the two stairs is 430 square meters. The lowest bid they (Stairs 15-17) have received to renovate the roof is 2,500 HUF/square meter, resulting in a total cost of 1.075 million HUF. Both stairs must be done at the same time. The building is not a good candidate for attic flats; an elevator would be required.

As we discussed financing, we focused on the two commercial units. Although they are leased month to month, the tenants seem long term. This could be important, because prospective lenders may require that the lease term on a unit used as security be as long as the term of the loan. From further discussion, however, it appears the two commercial units are not units, but rather common space. We finally concluded that this would not present a problem, because each association would be borrowing less than 500,000 HUF, and for loans less than 500,000 HUF OTP does not require liens. The associations can pledge the cash flow (rental stream). The team and the common representative settled upon the following scenario:

The roof renovation—1 million HUF cost, or 500,000 HUF per association. Each association pays 150,000 HUF cash and borrows 350,000 HUF. A five year 6% loan costs 6,766 HUF per month.

DISTRICT III BUILDINGS

Bogdáni 18

Eva Gerohazi, Marvin Price and Mr. Galambos, the common representative, met with Mr. Jozsef Csendes at the property. Mr. Csendes is an owner of the firm Flotta-Form. Flotta-Form is a construction company, which among other things, develops attic flats on existing buildings. They have to date developed and sold approximately 120 attic flats.

Their procedure is to cut a deal with the association whereby the association grants them the right to build on the roof. In return they will renovate the exterior and interior public spaces of the building. This consists primarily of minor repairs and painting, work which will improve the marketability of the new flats. Flotta-Form takes full financial responsibility for developing and selling the flats and takes the profit or loss as well.

We learned the following facts:

! Bogdani 18 is not the best suited to attic flat development because of its footprint; it is a very narrow building. As a result the rooftop space would be used less efficiently, although not enough to be a “deal killer.”

! Flotta-Form believes an elevator is not necessary to market the units. An elevator would destroy the economics of the transaction.

! Flotta-Form has successfully obtained building permits to build attic flats where there was no master plan in place. Unfortunately there is no guarantee, and a complete set of construction drawings is required for the permit application.

! Mr. Csendes expressed interest in working with Mr. Galambos. His firm is not willing to spec the cost of the plans, however. The master plan, or lack thereof, remains a problem.

LENDING SECTOR

OTP Condominium Loan Regulations

On June 2 Éva GerÅhazi and Marvin Price met with Mrs. Harkai of the OTP Bank. Mrs. Harkai informed us that the new regulations for the program had been approved and were being published. She expected them to be in the hands of the branches during the week of June 8. She did warn that the documents were lengthy and would not be easy reading. She added that it would be difficult to predict how the branches will interpret them.

We discussed several troubling features of the program. The first regards the remainder (or surplus) calculation. The bottom line here is that the regulations restrict loan size to a amount which can be supported (debt service) by 50 percent of the remainder, or operating surplus of the owners' association. This same holds true even when an association plans to increase fees to cover debt service. The bank is looking for debt service coverage for its primary protection.

A second issue regards appraisals. If a loan exceeds 1 million HUF, appraisal of the collateral is required. In the case of Szechenyi individual flats will comprise the collateral for one loan to the association. Because the loan exceeds 1 million HUF each owner may be required to obtain an appraisal, even though his pro rata share of the loan is 50,000 HUF. The problem here is that an appraisal costs 40,000 HUF.

Collateralization remains the same. It is still a 40 percent loan to value ratio.

Although we had a good discussion about these issues, Mrs. Harkai ended it by reminding us that the regulations were approved and not subject to further revision. We would have to work things out with the branches.

The regulations were supposed to be executed later in the week of this meeting, and Mrs. Harkai assured us she would expedite delivery to the Szekesfehervar and Miskolc branches. In fact the regulations still had not been executed and released to the branches on June 12, 1998.

PostaBank

Katie Mark, Carol Rabenhorst, Eva Gerohazi and Marvin Price met with Dr. Edit Kakuk, head of the department of individual loans for PostaBank on June 10, 1998. Also from the bank were representatives from the following departments:

— Legal
— Organization and Theoretical Management
— Construction
— Technical Aspects

PostaBank is preparing to implement a loan program for condominium renovation. The bank has had condominium association accounts. The philosophy is that to have a meaningful relationship with these clients, the bank must get involved in renovation.

The bank has encountered the same legal and technical concerns as other banks and is struggling to cope with them. They also have questions about the market, demand and cost effectiveness of renovation loans. They agree that without the state subsidy financing condominium renovations is very difficult. They recognize that the subsidy program is very rigid.

They have not previously announced a condominium product, because they have been waiting for the new condo law. They are still waiting for official interpretation of many questions about the law.

They have been making housing loans since September 1997. They offer market rate loans and 4-3-1 subsidy loans. Past practice has been to loan to individuals. They do not lend less than 100,000 HUF. For renovating a flat they will typically loan between 500,000 and 1 million HUF to an individual. They have done a few loans for the purpose of funding payment of utility arrearages; loan size has been less than 100,000 HUF.

Their observations of the OTP experience have led them to conclude that loans of the type being considered must be viewed individually; that is, each loan will be uniquely different from every other loan. Notwithstanding this, they want to establish a framework within which to underwrite and administer the loans jointly.

One of the bank's concerns is minority challenges in court of a majority vote. The bank will not know of the challenge. They can request information from the court, but feel there is only a 50 percent chance the court will respond. Thus they must rely upon the association to certify that an appeal has not been filed. As a result the bank's present position is to require 100 percent approval by owners of a renovation project and financing therefor. Parenthetically, the banks' attorney during the course of this discussion stated that a recent decision in the Chamber of Judges held that a 2/3 vote was required to approve renovation projects.

Another matter troubling the bank is loan servicing. They cited the Budapest buildings—old, lots of elderly and poor, arrearages, etc. The question is: can these associations pay? Related to this is the subject of lien structure. According to the representatives of PostaBank, at issue here is the situation wherein the bank's lien is not first. Second and lower liens do not automatically move up if the first is satisfied. The owner can reserve the "first" spot for a year.

PostaBank is leaning toward individual loans, rather than one loan to the association.

PostaBank would accept municipal guarantees, depending upon the financial condition of the municipality.

MUNICIPAL PROGRAMS

District XIX, Budapest

Éva GerÅhazi and Marvin Price met with a representative of the planning office in District XIX. This district has several interest free loan programs for home purchase and renovation. In one program tailored to young couples, borrowers can obtain a loan for up to 850,000 HUF plus a grant of 150,000 HUF. Other loans are smaller.

This district actively promotes and assists attic conversions. They focus primarily on panel buildings of four stories. They have an application process to which they respond. Typically applications come from owners' associations, and the district helps them get started. The district helps the association find an investor and will play the role of investor until one is found.

They are presently working with an association that is planning to add 6 attic flats in a 2 stairwell building. There will be an additional 320 square meters under roof, of which 276 square meters will be usable. The total cost of the project is estimated between 25 and 30 million HUF. To date the district is paying for the design, anticipating a private investor will be found. However, they have allocated 30 million HUF and are prepared to take the project to completion if necessary, acting as the investor/developer.

The district expects the condominiums to follow a model design. It provides capital in the name of the condominium and is repaid from sale proceeds. It is not clear, but apparently any surplus is used for other renovations and is buried as a cost of the job, so the condominium shows no profit. This is, of course, in the case where there is no private investor.